

**BEFORE THE  
SURFACE TRANSPORTATION BOARD**

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Ex Parte No. 705

**COMPETITION IN THE RAILROAD INDUSTRY**

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**Opening Comments of  
M & G Polymers USA, LLC**

M & G Polymers USA, LLC ("M&G") hereby submits these Opening Comments in response to the Notice issued by the Surface Transportation Board ("Board" or "STB") in this docket on January 11, 2011. In the Notice, the Board invited comments and scheduled a public hearing to address "the current state of competition in the railroad industry and possible policy alternatives to facilitate more competition, where appropriate." Notice at 1. The Board stated that it has been "some time" since the agency conducted a thorough analysis of these issues, and that certain fundamental developments have occurred in the railroad industry in the interim. Notice at 2-3. M&G commends the Board for instituting this proceeding, as it believes there is an ever-increasing lack of competition in the rail industry, creating severe problems for American business. M&G believes the Board should take action to facilitate greater competition.

**I. IDENTITY AND INTEREST OF M&G.**

M&G is a corporation organized under the laws of the State of Delaware, with its principal place of business in Apple Grove, West Virginia. M&G is part of M&G Group, which is the world's third largest producer of polyethylene terephthalate ("PET") for packaging applications and a technological leader in the polyester market. M&G produces PET in North

America at Apple Grove, WV and Altamira, Mexico. M&G is a major user of rail service to transport its products to customers throughout the continental United States, Canada, and Mexico. M&G also receives, via rail, certain raw materials used in PET production. M&G's Apple Grove facility is captive to CSX Transportation, Inc. ("CSXT").

PET is a plastic pellet substance that is widely used by M&G's customers in many consumer and industrial applications such as plastic bottles, food packaging, and carpet fiber. The PET business in the United States is highly competitive, with domestic and international producers all vying for the same customers, and it is not at all unusual for a customer to switch its primary supplier every few years. Product quality and cost are the two most important competitive factors.

## **II. COMMENTS OF M&G.**

As stated by the Board, the purpose of this proceeding is to "explore" both the current state of competition in the rail industry and also possible changes in the Board's competition policies. Notice at 1. The Board indicated that this proceeding would assist it in determining whether or not "any" measures should be taken by the Board. Notice at 5. In these Initial Comments, M&G will primarily describe its own recent experiences with competition (or the lack thereof) in the rail industry. M&G will explain the frequent absence of competition that it has encountered in order to show that Board action is necessary to facilitate and increase competition in the rail industry.

### **A. Rates Have Dramatically Risen To An Unsustainable Level.**

M&G has been forced to pay increasingly high rates for rail transportation in recent years. During the economic slowdown of 2008-2009, prices dropped on goods and services throughout the economy. While trucking companies reduced their rates in an attempt to increase

business, railroads providing transportation to M&G did not follow suit. Instead, the railroads restricted capacity by closing facilities and, generally, curtailing supply. Rail rates have simply continued their inexorable climb, especially now that the economy is growing again and truck supply is very tight.

With these rate increases, railroads have curtailed West Virginia's economic growth. In M&G's experience, the railroads' desire for ever-increasing rates even supersedes the promise of additional traffic. The PET business is competitive, and M&G is always searching for new markets for its products. Unfortunately, rail rates are a major impediment to M&G's ability to grow its business. Due to this unfavorable environment, M&G is evaluating options to move production capacity from a captive production location to one that has competition and, as a result, much more favorable transport economics.

**B. Even Where Competitive Options Theoretically Exist, Railroads Often Decline To Compete.**

M&G has experienced numerous situations over the past few years where the existence of competitive transportation options on paper does not translate to reality. M&G has observed that the two major eastern railroads, CSXT and Norfolk Southern Railway ("NS"), tend to quote similar rates to locations that are served by both of them. These two railroads also raised their demurrage rates around the same time, and they have both refused to enter into long-term contracts.

The refusal to compete is especially apparent when M&G attempts to use a rail-truck transload movement to provide a competitive option to a captive rail destination. To determine if M&G is attempting to "truck around" a competing rail carrier, railroads often ask M&G the identity of the ultimate customer when M&G requests a rate quote to a bulk transload facility. In

a truly competitive market, the railroad delivering to a bulk terminal should not care who is the ultimate recipient of the cargo by truck.

If a railroad is already serving a PET consumer not supplied by M&G, and M&G attempts to bid for that business, M&G has discovered that the railroads have little interest in offering a competitive transportation rate so that M&G can supply the consumer. In the railroad's mind, the business already belongs to it (because the railroad serves the customer) so there is no need to provide a competitive transportation rate to help M&G win the business. Even when M&G can show that it would grow the business and increase traffic, the railroads' rates do not budge. The above example highlights an important point. Most of M&G's customers are captive to a single railroad and M&G has found the railroads insensitive to their rates precluding or being fatal to an M&G business opportunity.

In conversations with the railroads, M&G has often heard that rates are set at the "market level" or "what the market will bear." These statements have always seemed incongruous because, in many if not most instances, they are used to describe a situation where only one rail route is possible and, therefore, there is no competition and no "market." The PET business is particularly hamstrung because a single railroad, CSXT, serves the vast majority of the PET producers in the U.S. There is no market for PET transportation if it is dominated by one railroad.

**C. Railroads Often Inhibit or Restrict Competition When Possible.**

M&G has also found that, where rail options exist on a particular route, railroads frequently take whatever steps possible to eliminate that competition. For example, the North America supplier of a key M&G feedstock material for PET production is located in Canada. M&G receives deliveries of this material in joint-line service via CN and CSXT, with

interchange at Toledo, Ohio. There is no rail competition for this movement. M&G's Canadian supplier has various other business throughout the U.S. with CSXT. When the Canadian supplier transferred some of its non-M&G traffic away from CSXT to NS, CSXT told the Canadian supplier that its captive M&G traffic rates would increase to make up for the lost revenue. Thus, the railroads use their captive traffic to preclude truly market-based pricing on completely separate traffic that actually has theoretical competition.

Another way that railroads eliminate rail competition is by leasing track to M&G's customers that tie the customer to a single railroad. Because M&G, not M&G's customer, pays the freight, M&G is left holding the bag for the increased line-haul rates due to the elimination of rail competition. A case in point is an M&G customer in the Midwest that is open to reciprocal switching and theoretically had rail competition between BNSF and UP. Unbeknownst to M&G, BNSF offered to lease track space to the customer for railcar storage, but with a provision restricting the lease track's use to only railcars moved by BNSF in line-haul service. Moreover, railcars transported by UP incurred a switching fee of \$500 under the Lease. M&G only learned of this restrictive lease when it attempted to ship a railcar to the customer via UP. When BNSF charged the customer \$500 for the switch, the customer directed M&G to only ship via BNSF in the future.

Railroads also use routing and bizarre pricing to limit M&G's ability to obtain competition and/or reasonable rates. For example, the Apple Grove facility is approximately 14 rail miles from a potential connection to NS at Point Pleasant, WV, and 35 miles from another potential connection to NS at Kenova, WV. However, routing protocols used by CSXT and NS mean that M&G products are often interchanged in Cincinnati (188 miles away) or other distant cities, thus forcing M&G to use CSXT for a significant distance.

Even where these routing protocols do not apply, CSXT's irrational pricing curtails M&G's ability to use the closest connection points to NS. In particular, the CSXT tariff rate from Apple Grove to Cincinnati is \$2794 + Fuel Surcharge of \$75.20 (188 miles at \$0.40 per mile), creating a total rate of \$2869.20. This equates to \$15.26 per mile for the 188-mile trip. In contrast, the CSXT tariff rate from Apple Grove to Point Pleasant is \$3074 + Fuel Surcharge of \$5.60 (14 miles at \$0.40 per mile), which produces a total rate of \$3079.60, or \$219.97 per mile. Similarly, the CSXT tariff rate from Apple Grove to Kenova is also \$3074 + Fuel surcharge of \$14.80 (35 miles at \$0.40 per mile), which is a total rate of \$3088.80, or \$88.25 per mile. The CSX is clearly curtailing competition by making it fourteen times more expensive (per mile) for M&G to convey traffic to the competition at the nearest location.

If M&G had a sensible opportunity to interchange to NS at Point Pleasant or Kenova, the deleterious effects of an excessively high CSXT rate could be mitigated by competition between CSXT and NS from the interchange. Additionally, shorter and more efficient routings would be possible to certain M&G customers.

**D. Railroads Have Begun Using Demurrage And Other Sources As Revenue Streams.**

Despite the significant and continuing rate increases noticed by M&G and described in these Comments, M&G has also become aware that railroads are using other means to increase their bottom lines. Demurrage is a prime example. Both Class I railroads and shortline railroads have dramatically increased demurrage charges recently, with some railroads' charges jumping from \$20 per day to \$75 per day.

Many railroads are not only increasing demurrage fees but also enforcing demurrage very strictly. The key factor that makes demurrage an additional revenue stream, however, is that railroads are also increasing the likelihood of demurrage by reducing the number of days that a

customer is switched and by consolidating operations through reduction of rail yard space. Due to this artificial limit on capacity, congestion is increased and cars are bunched. For many customers, M&G ships products on a continuing and staggered basis so that the customer has a steady supply (such as one or two railcars per day) for its ongoing operations. Due to the railroads' artificial reduction in capacity, these railcars get stuck in congestion and are bunched together in groups of 8, 10, or more. Many customers cannot accept delivery of this many railcars in a single day, and, as a result, the railroad charges demurrage when holding the railcars on railroad track until delivery can occur.

As a consequence of poor railroad service, congestion, and bunching, some M&G customers have been forced to increase the amount of on-site PET inventory. Not only is this inefficient for the economy at large, but it also leads to even greater congestion because many customers use railcars to store this inventory and any on-site storage consumes the customer's track space. Also, because PET is shipped in private railcars, M&G must increase its fleet size to accommodate this extra inventory. This is an example of how railroads reduce their costs by shifting them to rail customers.

Railroads have also used their rate adjustment indices as revenue streams. In prior years, some of M&G's contract rates were adjusted annually by a blend of the RCAF-U and RCAF-A indices. As a result, a reduction in railroad costs from productivity enhancements was partially shared with M&G. Now, however, M&G's rates are almost universally adjusted using the All-Inclusive Index Less Fuel ("AIILF"), which does not include the impact of railroad productivity. This is a form of stealth rate increase for the railroads.

**E. Railroad Actions Are Harming Domestic Business And Pushing Production Overseas.**

M&G's experience over the past several years reveals the harm incurred by domestic production from the lack of competition in the rail industry. As amply shown by shipper organizations participating in this proceeding, the major American railroads have enjoyed great financial success for years. However, the railroads are thriving at the expense of the greater economy. M&G has experienced this phenomenon first-hand. As mentioned earlier, M&G has two PET production units in North America, at Apple Grove, WV and Altamira, Mexico. While Apple Grove is captive to a single railroad, the Altamira facility is dual-served. For shipments from Altamira into the United States, M&G is able to choose the initial American railroad because M&G can select which border crossing to use. As a result of the competitive options existing for Altamira traffic, but absent for Apple Grove traffic, M&G has found that rail rates from Altamira to the western U.S. have R/VC ratios that average approximately 40% to 50% less than ratios for rates from Apple Grove to the same destinations.

This rate differential is pushing PET production away from the U.S., as shown by two examples from M&G's own business. First, PET shipments into the Pacific Northwest are roughly equidistant from M&G's Apple Grove and Altamira facilities, but the significant savings in rail cost attributable to competition means that M&G produces that PET at Altamira rather than Apple Grove. As a second example, the cost to M&G to ship PET from the Mexico-U.S. border to a small city in the Northeastern U.S. is less than the rail cost from Apple Grove to the same city. Again, this perverse pricing creates an incentive for M&G to produce PET in Mexico rather than the much closer Apple Grove facility.

Imports from overseas also have the distinct advantage of either bypassing the railroad altogether or being able to create competition by having the freedom to select the incoming port



(and servicing railroad). M&G has lost business to imports in locations as close to the coast as Washington state to as far as 400 miles from the nearest port – the reason being that our logistic costs were non competitive.

**F. The Expense and Time Required to Obtain a Lawful Rate Exacerbate the Harm from a Lack of Competition.**

The absence of competition in the U.S. rail industry is doubly harmful to captive shippers because of the great expense and time required to obtain lawful reasonable rates under the current Board procedures. Where competition does not exist, railroads benefit from the extreme expense, length, and uncertainty of rate cases because shippers are forced to either accept the high cost of increased rail rates or the high cost of litigating a rate case. In other words, the time and cost of a rate case reinforce railroad anti-competitive behavior and even encourage railroads to set unreasonably high rail rates on captive, non-competitive lanes.

Due to the ever-increasing rail rates experienced by M&G in the last several years, M&G finally had no other option but to file a rate complaint at the Board against CSXT in Docket No. 42123. This case has imposed a large financial burden upon M&G and, as-stated previously, CSXT's rates threaten the long-term economic sustainability of the Apple Grove, WV site. Not only are the existing rate reasonableness rules onerous, but the Board's recent decision to lengthen the procedural schedule in Docket No. 42121 reflects a change from standard practice that requires shippers to expend additional time and money to complete the rate case process.<sup>1</sup>

By the time the Board issues a decision in M&G's rate case, M&G expects that it will have spent \$15 million to \$20 million in consultant fees, legal fees, and payment of inflated tariff rates during a three year period just to obtain what should be M&G's right – a reasonable rail

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<sup>1</sup> In Docket No. 42121, the Board granted a CSXT motion to bifurcate the procedural schedule in the case, and in so doing, effectively extended the procedural schedule by 6-9 months. CSXT has filed a similar motion in M&G's rate case, which the Board has not yet decided.

rate. Although the legal and consultant expenses are substantial in their own right, the vast majority of this cost estimate is attributable to the inflated tariff rates. Whether or not M&G recoups that expense in reparations, the Board needs to recognize that M&G must commit those resources without knowing if and to what extent they will be recovered. Every time the Board lengthens its rate case process, as it did in Docket No. 42121, it forces plaintiff shippers like M&G to take even greater financial risks. This is clearly a hurdle that is not sustainable. If the Board cannot devise a more expedient and less costly rate reasonableness method to protect captive shippers from railroad market power, it needs to create greater competition that will allow the marketplace to do the job.

**G. Action By The Board Is Warranted To Facilitate Competition.**

The Board specifically asked in the Notice whether it can and/or should take any action to facilitate competition in the national rail industry. Given the harms experienced by M&G from the current lack of rail competition, M&G believes that railroads should be required to quote Bottleneck rates and that reciprocal switching opportunities should be greatly expanded. M&G will not separately address the authority of the Board to take these actions; instead, M&G joins in the comments of the several shipper organizations regarding Board authority.

Bottleneck rates could help M&G to minimize its captivity to CSXT at Apple Grove by enabling it to interchange PET with a competitor for a greater portion of the route. It also would simplify M&G's ability to ensure that the bottleneck rate is reasonable under the Board's regulatory standards. As noted above, M&G has challenged the reasonableness of CSXT's rates from Apple Grove in Docket No. 42123. Because of CSXT's extensive bottleneck segments, M&G's rate case is one of the most complex ever filed at the agency, requiring M&G to design

an approximately 5,000 mile stand-alone railroad. A bottleneck rate could reduce that to under 50 miles.

Reciprocal switching would benefit M&G most at destinations where its customers are captive to a single railroad. Even if M&G had rail competition at Apple Grove, it still would be captive (at least in the East) to whichever competitor also served the destination. Reciprocal switching would resolve that problem by enabling both competitors to provide competitive service.

Taking these two actions does not guarantee rail competition, but it at least makes competition more likely. Reciprocal switching only succeeds at creating competition if the second railroad actually wants to compete. The rail industry, however, has consolidated to the extent where just two carriers may not be sufficient to spur competition. So long as competition is restricted to a few geographic areas, it is easier for two railroads to not challenge the other competitively. Each has an understood franchise over certain customers that are off-limits to the other. Therefore, the best way to ensure competition is to substantially increase the number of competitive locations so that it becomes much more difficult not to compete.

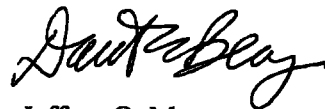
Board action is all the more necessary because consolidation in the rail industry has dramatically reduced the ability of current regulatory policies to foster competition. The rail mergers of the past 20-30 years have resulted in only two major railroads in the East and two in the West, thereby limiting not just routing options but also the ability to use alternate railroads and the potential for competition.

Finally, no competition enhancement policy can succeed if the price of access is too high. The Board must be committed to ensuring reasonable bottleneck and reciprocal switch rates. Otherwise, a railroad can preclude competition merely by its access pricing.

### **III. CONCLUSION.**

In the Notice, the Board stated that one purpose of this proceeding is to determine “if any” changes are warranted to the Board’s competitive access rules and policies. Notice at 5. As described herein, M&G regularly encounters a harmful lack of competition in the rail industry and, as such, M&G firmly believes that the Board should implement changes to its rules and policies to increase competition in the national rail system.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Jeffrey O. Moreno".

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